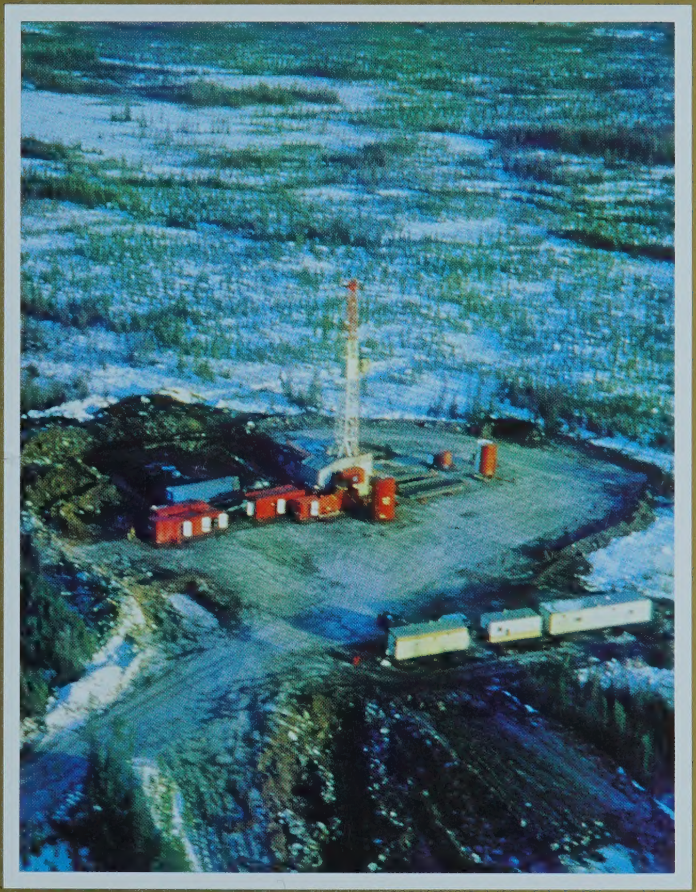
CZAR RESOURCES LTD.

1989 Annual Report



CZAR RESOURCES LTD.
and Subsidiary Companies

RECD MAY 17, 1990

Corporate Profile

Czar Resources Ltd. is an independent Canadian energy company engaged in the exploration for and development and production of natural gas reserves in western Canada and the marketing and sales of natural gas to markets throughout North America.

Czar's natural gas marketing strategy is based on the development of long-term contracts supplying gas to geographically diversified users with secure transportation arrangements.

Czar's exploration and development strategy continues to target natural gas in the western Canadian basin. The Company plans to steadily expand its existing reserves base in order to meet the natural gas reserves obligations of existing contracts and to explore in areas where new contracts may be obtained.

Czar possesses all of the ingredients required to successfully implement these strategies:

- a qualified and experienced staff;
- large natural gas reserves — 195 billion cubic feet of natural gas located in Alberta and British Columbia with a well developed infra-structure of production facilities;
- natural gas contracts which provide current cash flow and allow for future exploration and development successes to be contracted;
- extensive land holdings (141,000 net acres) for future reserve development; and
- the cash flow required to fund its exploration, development and acquisition activities.

Corporate Objectives

Czar's corporate objectives are to demonstrate per share growth in earnings, cash flow and asset value and growth in natural gas reserves while enhancing the Company's financial strength by controlling its financial leverage.

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Cover Photo

Czar et al Helmet d-35-A/94-P-10 drilled in January, 1989. This well is the most significant in the Company's history and has produced at an average rate of 6.7 MMCF/D since being placed on stream in March of 1989.

Annual Meeting

The annual meeting of the shareholders of Czar Resources Ltd. will be held on June 7, 1990, at 3:00 p.m. in the Delta Bow Valley Hotel, 209 Fourth Avenue, South East, Calgary, Alberta.

Highlights

(thousands unless otherwise indicated)

Financial	1989	1988
Total Revenue	$ 21,160	$ 16,194
Cash Flow from Operations	$ 6,799	$ 5,061
Cash Flow Per Share	$ 0.24	$ 0.18
Net Earnings	$ 1,301	$ 1,472
Net Earnings Per Share	$ 0.05	$ 0.05
Capital Expenditures	$ 11,105	$ 9,985
Total Assets	$ 61,300	$ 53,973
Common Shares Outstanding	35,556	27,637

Operating	1989	1988
Production (Before Royalties)		
Natural gas (BCF)	14.6	10.8
Average daily production (MMCF/D)	40.1	29.4
Crude oil and natural gas liquids (MSTB)	136	154
Average daily production (BOPD)	374	438
Drilling Activity		
Gas completions	15	15
Dry and abandoned	3	4
Total wells	18	19

Undeveloped Land Holdings (acres)	Gross	Net	Gross	Net
Alberta	91,131	43,624	100,555	42,473
British Columbia	231,556	97,490	207,545	85,483
Total acres	322,687	141,114	308,100	127,956

Reserves (proved and probable)	Before Royalties	After Royalties	Before Royalties	After Royalties
Gas (BCF)	195	155	197	157
Oil and NGL's (MSTB)	1,161	908	1,443	1,134

Abbreviations

Throughout this report, standard oil and gas abbreviations have been used. Their explanation is as follows:

BBLS	Barrels
MSTB	Thousand Stock Tank Barrels
BOPD	Barrels of Oil Per Day
MMCF	Million Cubic Feet
MMCF/D	Million Cubic Feet Per Day
BCF	Billion Cubic Feet

To The Shareholders

For the second year in a row I am pleased to report that the company has just completed the most successful year in its history. 1989 was a pivotal year for Czar in that the Company achieved its objectives of per share growth in revenue, cash flow and natural gas production, while greatly improving its financial strength.

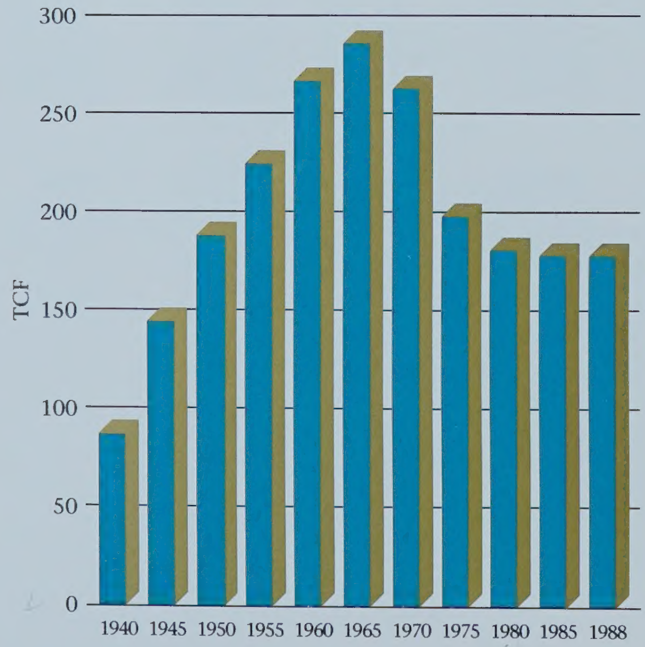
The year was highlighted by:

- record natural gas production of 14.6 BCF, a 30% increase over 1988 production;
- record total revenue of $21.2 million, a 31% increase over 1988 revenue;
- cash flow increased to $6.8 million, a 35% increase over 1988 cash flow;
- a $9 million private placement of common shares and share purchase warrants, completed at year end, allowed Czar to reduce its debt to the lowest level since 1979;
- flow-through share funding of its exploration, combined with the reinvestment of the Company's record cash flow on development and reserve acquisitions, resulted in reserve additions for the year of 162% of the Company's natural gas production;
- a long term joint venture and management agreement with Orbit Oil & Gas Ltd., pursuant to which the companies will share overhead costs and jointly participate in new exploration and development projects, provides the Company with the "Critical Mass" necessary to more effectively compete in the natural gas industry.

Czar's improved results are attributable to a concentration on Canadian natural gas. For several years we have held the view that the fundamentals of the natural gas industry in Canada were steadily improving due to the continued deterioration in the natural gas reserve base in the United States. This view is based on the following observations:

- United States reserves have declined steadily since 1969 and are currently at the lowest level since 1945;
- United States gas replacement remains at its lowest level in the last decade;
- rig activity to replace gas reserves collapsed in the 1980's and remains low due to the extended period of low prices;
- in the past three years, United States imports of Canadian gas increased to record levels indicating a substantial import demand at market clearing prices; and

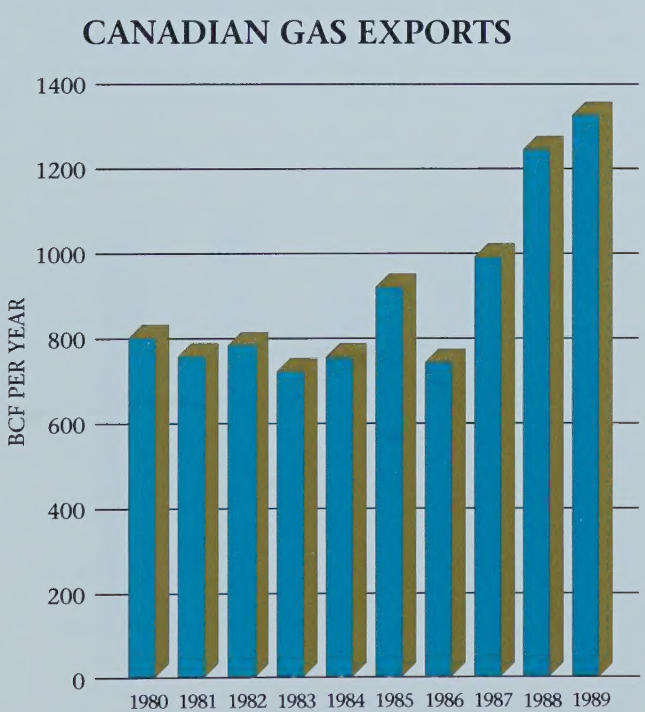
U.S. GAS RESERVES
(Lower 48 States)



- the relatively poor annual reserve additions during the drilling boom of the early 1980's suggests that most of the gas prone basins have been thoroughly exploited and are reaching the mature stage of their development.

The situation in western Canada, however, is more favourable as this basin has been quite sparsely drilled and the opportunities for finding large pools of gas still exist. Although Canadian gas prices have remained low and the marketing situation is extremely competitive, Czar's premise is that in the early 1990's large volumes of gas will be exported from western Canada to the United States, at substantially improved prices.

It is likely that this situation will result in a significant increase in the cash flow and asset values of companies like Czar which hold a strategic position with natural gas reserves, markets and production capabilities.



Corporate Strategy for the 90's

Markets

To take advantage of the combination of improving industry conditions and Czar's sizeable natural gas reserves base, Czar concentrated its marketing efforts on long term natural gas contracts supplying gas to geographically diversified markets. Czar has primarily targeted natural gas aggregators with long-term, high price contracts and firm transportation arrangements in place. Following this strategy, Czar has recently concluded natural gas sales contracts totalling in excess of 350 BCF of natural gas reserves, including:

Alberta & Southern	220 BCF
KannGaz	55 BCF
Unigas	39 BCF
ProGas	31 BCF

Czar intends to follow this marketing strategy for the forseeable future.

Exploration, Development and Reserves Acquisitions

Czar has restricted its capital expenditures to cash flow and new equity financing. In 1989, capital expenditures were concentrated in areas in which the Company had developed reserves and existing production facilities. Consequently any gas discovered or purchased could be placed on production through the existing infra-structure, giving Czar a competitive advantage in the area.

Following this strategy, Czar continued to develop natural gas prospects in Alberta and British Columbia in 1989 and added an additional 23 billion cubic feet of reserves during the year. Czar has just completed it's most successful drilling season ever in the Helmet area in northeastern British Columbia. The Company acquired three wells and drilled six successful gas wells. In addition Czar and its partners installed 18 miles of pipeline and connected seven additional wells to the gathering system and increased the total deliverability from the Helmet area by over 12 million cubic feet per day.

Financing

We believe that with its technical expertise, land holdings, production infra-structure and natural gas reserves, Czar needed only to have a sound balance sheet to ensure that benefits from improving natural gas economics would accrue to the Company. Czar took a major step in this direction, raising $9,000,000 through a private placement of common shares and warrants which closed on December 29, 1989. The proceeds were used to retire long term debt. Czar also raised $1.1 million of flow-through share financing in December bringing its total flow-through funds available for its 1990 exploration program to $1.7 million.

Outlook

With the continuing improvements in natural gas industry fundamentals, Czar intends to continue to expand its production capacity, natural gas sales and natural gas reserve base during 1990. With a successful winter drilling program and the addition of production facilities, the Company has met natural gas contract requirements for 1990 and is now planning for 1991 and beyond.

Czar and its joint venture partners will continue to expand their reserves through exploration, development and carefully selected acquisitions.

On behalf of the Board of Directors, I would like to thank the management and staff for their efforts during a most successful year. I would also like to welcome Mr. Frank Benevento II to our Board of Directors and to thank Messrs. Ashley Down, Donald Deacon and Ed Mattheis for allowing their names to stand for nomination to the Board at Czar's next annual meeting. These additions will bring a wealth of experience to the Board and will be of great benefit to the Company in the coming years.

On Behalf of the Board

R.W. Lamond
Chairman of the Board of Directors

Financial

The financial results of the Company for 1989 were highlighted by:

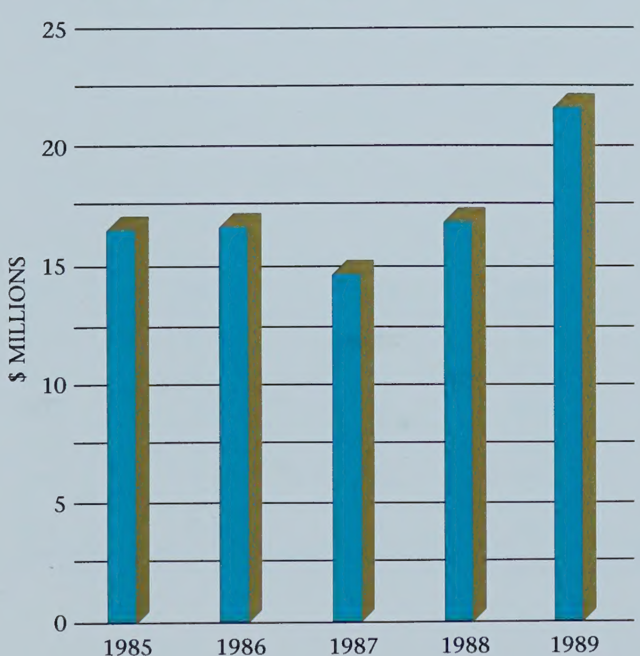
- a $9 million equity issue.
- the redemption of the Company's $37.5 million term preferred shares and the establishment of long term credit facilities.
- the private placement of $1.7 million flow-through shares for 1989 exploration activity, and a further $1.7 million of financing arranged for 1990 exploration.
- a $5 million joint venture arrangement with an industry partner for exploration activity in northeastern British Columbia.
- a joint venture and management agreement with Orbit Oil & Gas Ltd. covering future exploration and drilling activity.

Results of Operations

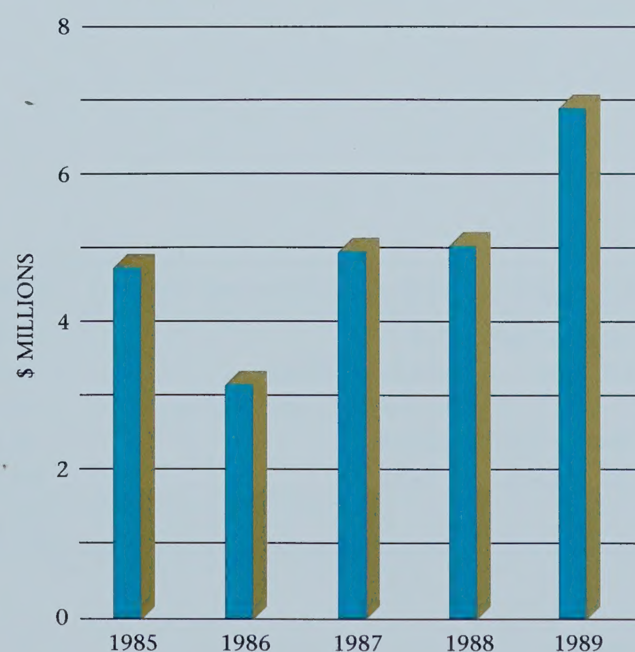
Total revenue of $21.2 million in 1989 compared with $16.2 million in 1988, resulting from record natural gas production together with modest improvements in product prices

Cash flow increased to a record $6.8 million or $0.24 per share in 1989 compared with $5.1 million or $0.18 per share in 1988. While production and overhead expenses declined on a per unit of production basis, these reductions were offset by an increase in total debt service charges. The increase resulted from the conversion of the $37.5 million of term preferred shares to bank debt in the spring of 1989.

GROSS REVENUE



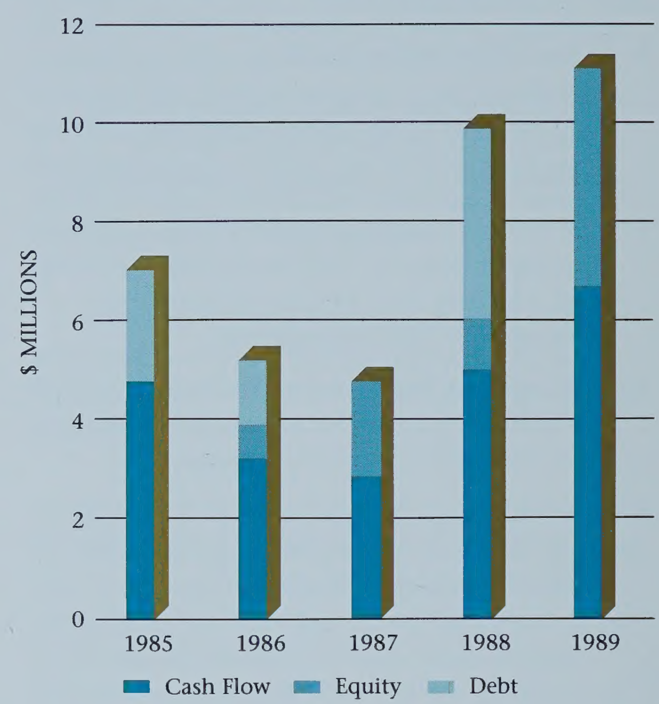
CASH FLOW



Capital expenditures increased to $11.1 million during 1989, from $10.0 million in 1988. As can be seen in the accompanying table, the capital expenditure program concentrated primarily on the construction of production facilities. These facilities, as well as increased land acquisitions were concentrated in northeastern British Columbia.

In October of 1989, the Company and its partners entered into a three-year exploration and development agreement with an independent industry partner to develop gas reserves in the Helmet area of northeastern British Columbia. Pursuant to this agreement, the Company and its joint venture partners, Orbit Oil & Gas Ltd. and Frobisher Resources Ltd., will expend 37.5% of the initial $5 million of funds for a 50% working interest in the venture. The early success of the joint venture in acquiring lands and drilling six wells, resulted in the expenditure of the initial $5 million during the first quarter of 1990.

CAPITAL EXPENDITURES



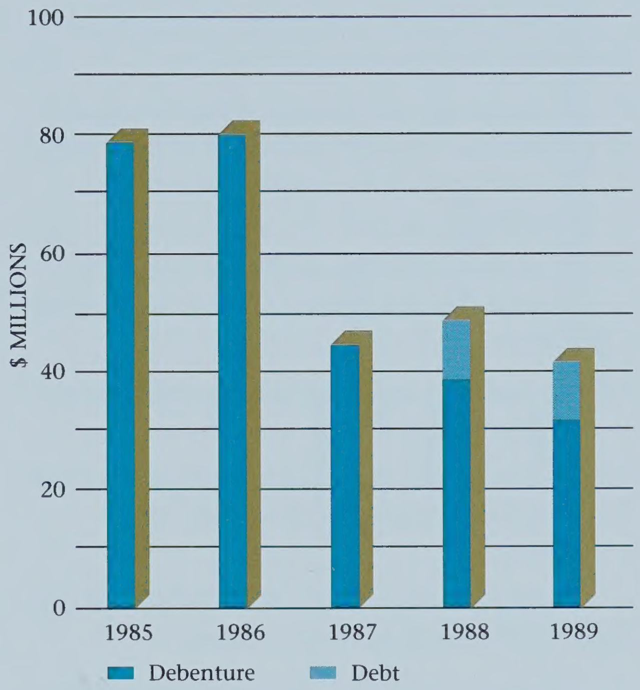
Capital Expenditures (Millions of dollars)	**1989**	1988	1987	1986	1985
Land acquisitions	**2.1**	1.2	1.0	1.0	0.9
Drilling – current operations	**2.9**	2.4	0.9	0.8	1.2
– flow through agreements	**1.1**	0.9	2.0	0.8	0.0
Production facilities	**5.1**	5.0	1.2	0.9	4.3
Incentives and Other	**(0.1)**	0.5	(0.4)	1.7	0.6
	11.1	10.0	4.7	5.2	7.0

In order to increase financial strength and reduce leverage, the Company issued 6.4 million common shares on December 29, 1989 at a price of $1.40 per share for an aggregate consideration of $9 million. These funds were used to retire existing bank debt. In addition, common share purchase warrants were issued which allow the purchase of a further 2.7 million common shares at an exercise price of $1.50 per share until December 31, 1992.

The Company's total debt and liabilities were $41.7 million at December 31, 1989, the lowest level in the last decade and down from $48.4 million at December 31, 1988. The Company currently has a credit facility of $34 million of which $26 million is being utilized. Repayment requirements are reviewed annually.

Changes in the presentation of the financial statements during 1989 were made to more accurately reflect production and revenue received by the Company from limited partnerships which were active in the early 1980's.

TOTAL NET LIABILITIES



Natural Gas Marketing

The Company's expertise in finding competitive markets for its natural gas has been a key ingredient of its success in the 1980's.

During 1989, the Company's natural gas marketing objectives were as follows:

- to maximize the volume of the Company's natural gas reserves dedicated to long term gas contracts, with market responsive pricing;
- to secure a diversity of market outlets to prevent the Company's reliance on any one market sector;
- to maximize deliveries under natural gas contracts; and
- to continue to expand the Company's share of natural gas production under these contracts.

During the year, major accomplishments in achieving these objectives included:

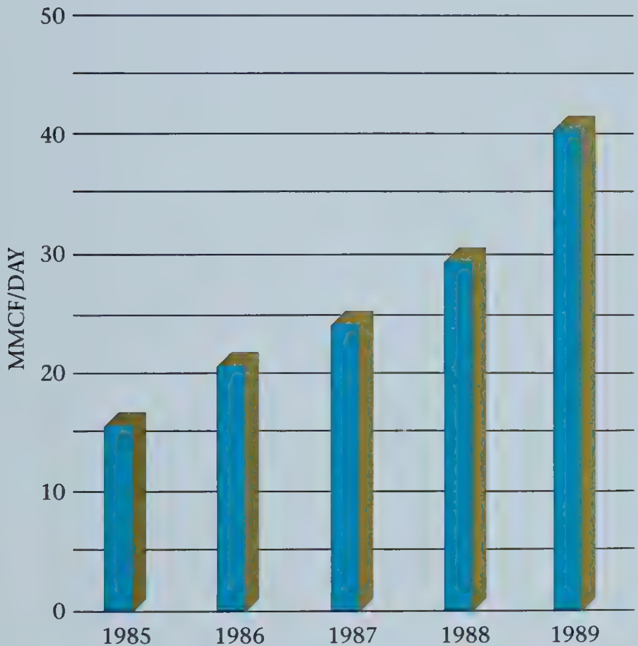
- February, 1989: the Company completed a major expansion of its gas production facilities in the Helmet area of northeastern British Columbia, resulting in a total deliverability of approximately 25 MMCF/D. The additional capacity allowed the Company to maintain deliveries to its existing sales contracts and commence delivery of 10 MMCF/D to the Alberta & Southern Gas Co. Ltd. contract in December, 1989. The pipeline network in Helmet was further expanded early in 1990, with an additional 18 miles of pipeline, and total deliverability was increased to 30 MMCF/D. The expansion is required to meet the increased contractual requirements of the Alberta & Southern contract of 20 MMCF/D in November, 1990, and to 30 MMCF/D in the following year.
- March, 1989: The Company entered into a contract with ProGas Limited involving the dedication of 31 BCF of reserves in the Elnora and Wimborne areas of Central Alberta. A refrigeration plant was installed at Wimborne to facilitate deliveries of 4 MMCF/D to ProGas under this contract.
- October, 1989: The Company completed the renegotiation of its major industrial contract with Sheritt Fertilizer Company, whereby deliveries were increased to 25 MMCF/D in return for a significant improvement of the pricing provisions.
- November, 1989: The Company entered into a long term contract with Unigas Corporation involving the dedication of 39 BCF of Alberta reserves to Unigas' markets in the U.S. Midwest. Deliveries to Unigas commenced in November, 1989 at 1.8 MMCF/D and will increase to 10.8 MMCF/D by March 1, 1992.
- December, 1989: The Company completed the installation of compression in north Monias, British Columbia, and increased deliverability from 10 MMCF/D to 16 MMCF/D to maintain supply to the Prince George Pulp industrial contract.
- The Company has submitted an additional 130 BCF to the Alberta & Southern export expansion project and plans to continue to develop reserves in northeastern British Columbia for this contract.

Heading into the 1990's the Company's gas marketing goals are to secure long term contracts which allow for the development of new natural gas reserves over a two to three year period and provide for connection of that gas to market in the mid 1990's.

Production

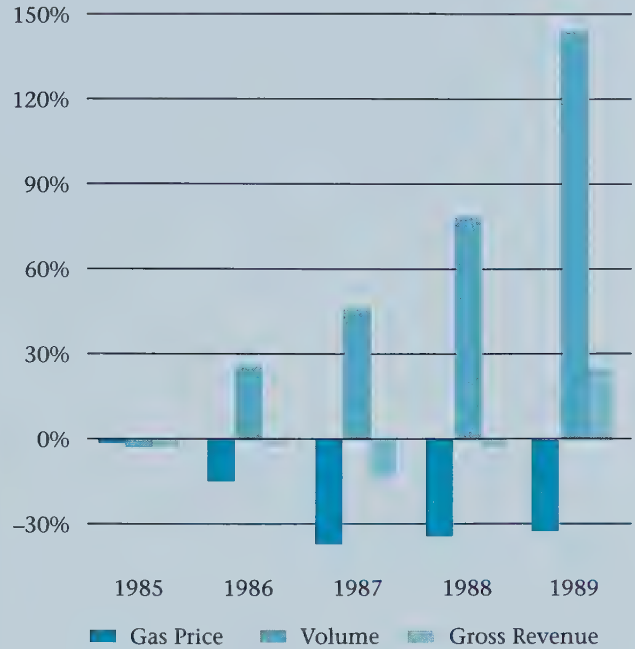
A major expansion of the Company's production facilities, combined with a successful drilling program, resulted in a 36% increase in sales of natural gas. Natural gas sales were at their highest level in the Company's history and averaged 40.1 MMCF/D in 1989, compared with 29.4 MMCF/D in 1988. Natural gas production reached a high of 45 MMCF/D in December 1989.

NATURAL GAS PRODUCTION



During the year the Company expanded its production capability at Helmet and Peggo in British Columbia and at Drumheller, Gadsby, Fenn West and Wimborne in Central Alberta.

PRICE - VOLUME - REVENUE PERCENTAGE CHANGE
(1984 Base)



During 1989 improvements in the prices received for natural gas began to have an impact on the production revenue received by the Company. Long term natural gas contracts with market sensitive pricing are expected to significantly improve the Company's netback prices in the future.

The price received for oil and natural gas liquids also increased in 1989. Greater stability in world markets resulted in more consistent pricing throughout the year.

Average product prices before royalties:

	1989	1988	1987	1986	1985
Gas, $/MCF	**$ 1.42**	$ 1.39	$ 1.33	$ 1.69	$ 2.07
Oil and NGL, $/BBL	**$ 16.52**	$ 14.47	$ 19.10	$ 17.47	$ 36.26

Exploration, Development and Reserve Acquisition Highlights

During 1989, the Company participated in the drilling of eighteen wells in Alberta and British Columbia. The Alberta wells were drilled on shallow Upper Cretaceous gas prospects. At Wimborne, 3 gas wells were drilled bringing to 8 the total gas wells in this pool. New pools were found at Chigwell and Stettler North. Three successful development wells were drilled in the Gadsby area and one was drilled at Bashaw. The Company acquired a 17% interest in a significant Upper Cretaceous well at Drumheller. The well was tied-in and is currently producing at a rate of 2.5 MMCF/D.

Natural gas reserves and production from this entire area are covered under an Alberta & Southern natural gas contract which requires 220 billion cubic feet of reserves to be dedicated by May 1, 1992. Natural gas deliveries under the contract commenced at 10 MMCF/D in December, 1989 and are scheduled to increase by 10 MMCF/D in each of the next three years to a total of 40 MMCF/D in the fall of 1992. The higher netback price for natural gas sold to Alberta & Southern substantially increases the value of the production and reserves from this area. The ability to cross dedicate reserves and production at Helmet also allows for the more economical, staged development of the pool.

Drilling Results

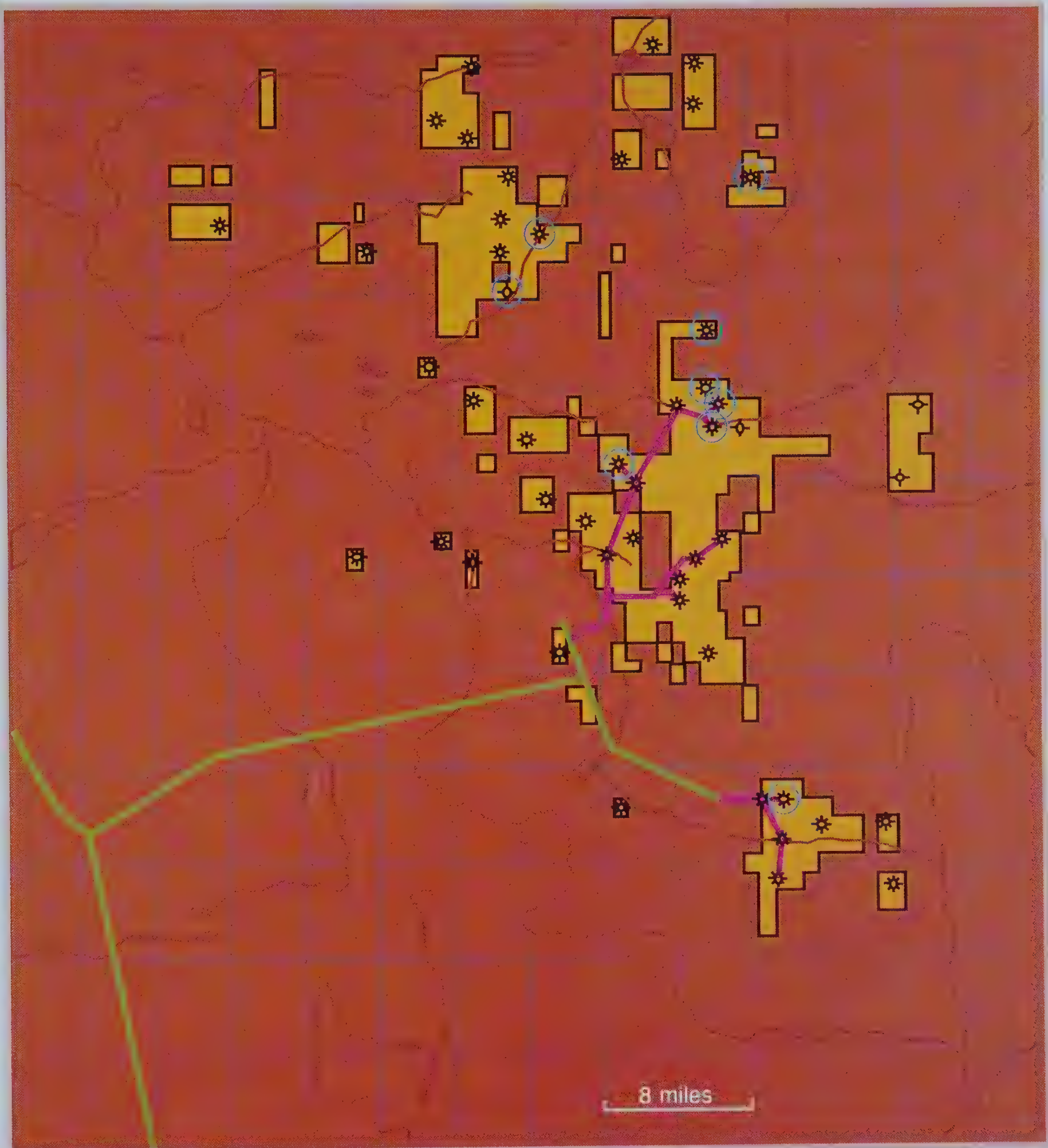
	1989		1988		1987		1986	
	Gross	**Net**	Gross	Net	Gross	Net	Gross	Net
Gas Wells	**15**	**9.3**	15	9.1	22	9.0	15	8.6
Oil Wells	**0**	**0**	0	0	1	0.9	2	0.1
Dry Holes	**3**	**2.0**	4	2.7	9	3.9	2	1.0
Total	**18**	**11.3**	19	11.8	32	13.8	19	9.7

Helmet Area

The Company's most active area in British Columbia in the last two years has been the Helmet prospect located in the extreme northeastern part of the province, where the Company currently has net interests in over 100,000 acres, of 232,000 gross acres. The Company has 51 wells located on the property, which 16 of are currently producing approximately 30 MMCF/D.

In 1989, the Company and its partners drilled six wells on the prospect and acquired two additional wells, adding eight Jean Marie gas wells and approximately 14 BCF of natural gas, net to the Company.

The highlight of the Company's 1989 drilling program was the Helmet d-35-A/94-P-10 well which was drilled in January and placed on stream in March and has averaged a production rate of 6.7 MMCF/d through its first year of production. The Company and its partners subsequently acquired additional interests in the well bringing the Company's interest to 61%.



HELMET AREA

West ~~Coast~~ ENERGY Transmission Pipelines

Czar Pipelines

89/90 Winter Drilling Program

With the Company's success in the area, increased industry interest resulted in extensive blocks of lands being posted at two Crown land sales early in 1990. In response Czar entered into a $5 million joint venture arrangement with an independent industry partner to finance increased land acquisitions and maintain its competitive position in the area.

Through it's joint venture activity, the Company has acquired an interest in 28,000 acres in the Helmet area and, since year end, has drilled five wells and acquired one well. The most significant well of this progam is the July Lake b-66-I/94-P-10 well which flowed gas at an approximate AOF of 100 MMCF/D. Czar has a 29% interest in this well which is expected to be placed on stream in early 1991.

With the Company's substantial land holdings in this area and the associated Alberta & Southern contract, it is anticipated that a significant portion of the Company's capital expenditures in 1990 and 1991 will be commited to Helmet.

Reserves

1989 Additions

The Company's exploration, development and reserve acquisition program replaced its natural gas production by 162%, before adjustments of prior years estimates.

Natural gas reserve additions before royalties were:

1989 Reserve Additions	Proved (BCF)	Probable (BCF)
Alberta	5.8	0.6
British Columbia	17.9	—
	23.7	0.6

Changes in Proven Reserves

The following table analyzes the changes in proven natural gas reserves from year to year over the last two years.

Reserve Continuity	Natural Gas (BCF)	Liquids (MSTB)
1988		
January 1,	158.6	1,482.9
Additions	20.6	1.0
Production	(10.8)	(154.3)
Adjustments	(2.0)	(39.4)
December 31,	166.4	1,290.2
1989		
Additions	**23.7**	**0.0**
Production	**(14.6)**	**(136.4)**
Adjustments	**(7.8)**	**(111.2)**
December 31,	**167.7**	**1,042.6**

An evaluation of the Company's oil and natural gas properties by an independent petroleum engineering consultant as at December 31, 1989 is summarized below:

	Reserves Before Royalties		Present Value (millions)			
	Natural Gas (BCF)	Oil & NGL (MSTB)	Undiscounted	Discounted at 10%	15%	20%
Proven						
Producing	78.4	704.6	$117	$ 69	$ 57	$49
Non-producing	83.5	338.0	155	53	35	24
Undeveloped	5.8	—	8	3	3	2
Total proved	167.7	1,042.6	280	125	94	75
Probable	27.1	118.0	44	13	7	4
Total	194.8	1,160.6	$324	$138	$101	$79
1989 Production	14.6	136.4				
Reserve life (years)	13.3	8.5				

As in prior years the company maintained a fairly equal distribution of reserves between Alberta and British Columbia. With the tie-in of seven new wells in British Columbia, the ratio of proved producing to proved non-producing reserves will increase. This will be reflected in the Company's next evaluation.

Summary of Natural Gas Reserves by Province

	1989 BCF	1989 %	1988 BCF	1988 %
Alberta				
Proven				
producing	**35.9**	**18.4**	35.9	18.2
non-producing	**39.9**	**20.5**	46.2	23.5
Probable	**12.9**	**6.6**	14.1	7.2
	88.7	**45.5**	96.2	48.9
British Columbia				
Proven				
producing	**42.4**	**21.8**	43.8	22.2
non-producing	**49.5**	**25.4**	40.5	20.6
Probable	**14.2**	**7.3**	16.4	8.3
	106.1	**54.5**	100.7	51.1
Production				
Alberta	**7.5**	**51.3**	5.2	47.8
British Columbia	**7.1**	**48.7**	5.6	52.2
	14.6	**100.0**	10.8	100.0

Finding and On-Stream Costs

One of the Company's primary objectives is to maintain its reserves by replacing its annual production.

The Company has been successful in finding reserves and placing them on stream for an average cost of $0.42 per MCF over the last three years.

The calculation of finding costs is based on annual reserves additions, excluding revisions, compared with annual capital additions for land, seismic, drilling and completion of wells and all production facility expenditures. These costs are reduced by government incentives and exclude other assets not directly required to maintain production.

Proven reserve additions are calculated on an equivalent of 10 MCF/BBL.

Finding and on stream costs	1989	1988	1987
Lease and reserve acquisitions	**$ 2,111**	$ 1,197	$ 1,052
Drilling and completion	**3,152**	3,372	3,204
Production facilities	**5,186**	5,048	1,132
Government incentives	**(244)**	(241)	(702)
	10,205	9,376	4,686
Overhead Capitalized	**749**	633	423
Total Net Expenditures on Reserve Additions	**$10,954**	$ 10,009	$ 5,109
Proven Reserve Additions	**23.7**	20.6	17.5
Per Mcf of Gas Equivalent	**$ 0.462**	$ 0.484	$ 0.292

Management's Discussion and Analysis of Financial Conditions and Results of Operations

General

The $9 million equity issue closed at year end improved Czar's financial liquidity by allowing for the reduction of long term financial obligations by $8.6 million and increasing the company's unused credit facilities to $7.6 million. In March 1989, Czar redeemed $37.5 million of term preferred shares with the proceeds from a long term credit facility negotiated with its banker.

In order to take advantage of the spread between U.S. and Canadian interest rates and reduce the Company's interest expense, Czar initiated a strategy of borrowing in U.S. dollar denominated loans with a partially hedged foreign exchange risk achieved through the purchase of options. Through these options, the principal amount of the borrowing is partially protected against foreign exchange losses. There is however a risk of losses due to declines in the foreign exchange rates for the Canadian dollar in excess of the options.

The 30% increase in production revenue is attributable to increased natural gas sales volumes. These increased sales are a reflection of greater demand for natural gas, additional gas reserves connected to market in March of 1989 and additional natural gas contracts. The Company's ability to expand the level of 1989 natural gas sales volumes is dependent upon obtaining new contracts and capacity on pipeline systems which serve these contracts. To date the Company has been able to successfully obtain pipeline capacity for its gas to match its expanding contractual requirements.

In 1989 approximately 15% of the Company's gas sales were exported to the United States through long term contracts. The payment for these contracts is at the spot market rate of exchange for the Canadian dollar.

In 1989 the cost to service the Company's financial obligations increased by $2.4 million. This is due in part to an increase in overall lending rates in Canada. However, most of the increase is referred to above. The term preferred shares, which were redeemed pursuant to their provisions, carried a dividend rate of approximately 7.35%. The interest rate on the credit facility used to retire the shares was a blend of a fixed rate of 12.61% and a floating rate of prime plus 1/4% which resulted in the increased debt service cost for most of 1989. Carrying costs are anticipated to decline in 1990 due to the reduced level of debt during the year after the equity financing completed at year end.

Depletion and depreciation expenses increased in 1989 due primarily to a 30% increase in equivalent units of production. However, depletion also increased as a result of the depletion rate increasing from $0.31 per equivalent Mcf of production in 1988 to $0.36 in 1989.

The Company has income tax deductions in excess of the book value of its assets by approximately $50 million and the value of these tax deductions has not been recognized in the financial statements. As a result there will be neither a current or a deferred tax provision in Czar's financial statements in the foreseeable future.

During 1989 Czar recovered approximately $640,000 of its overhead of prior years for operating natural gas plants and facilities jointly owned by Czar and its partners. This reduced 1989 general and administrative expense by approximately $640,000 and increased the Company's production expense by approximately one-third of that amount.

Expansion of the Company's production facilities, primarily in the Helmet area of Northeastern British Columbia, is required to continue to increase sales volumes and meet the deliverability requirements of its Alberta and Southern natural gas contract. In the first quarter of 1990 the necessary facilities for the Company to meet contract requirements for November, 1990 were put in place.

Liquidity and Capital Resources

The terms of the credit facility with the Company's bank requires a reduction in the line of credit available by $6 million during 1990. At December 31, 1989 Czar had sufficient unused lines of credit together with its free working capital to meet the required reductions in the credit line. The credit facilities require a review of the Company's "Lending Base" each year with a view to rescheduling any reductions.

Czar is therefore in the position to commit its cash flow from operations to capital projects rather than further debt retirement during 1990.

Sensitivity

Czar's financial success is to a degree dependent upon the economic environment within which it operates. To demonstrate the effect of key variables on Czar's operating results, the following table reflects changes in cash flow as a result from changes in variables.

Key Variable	1989 Base	Change in Variable	Impact on Annual Cash Flow $000	Impact on Annual Cash Flow $/Share
Natural Gas				
Production Mmcf/d	**40.0**	1.0	$280	$0.008
Price $/Mcf	**$1.42**	$0.10	$1,285	$0.036
Interest Rates (Prime based)	**13.5%**	1%	$100	$0.003

Auditors' Report

To the Shareholders of
Czar Resources Ltd.

We have examined the consolidated balance sheets of Czar Resources Ltd. as at December 31, 1989 and 1988 and the consolidated statements of earnings and deficit and source and use of cash for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1989 and 1988 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in presentation of previously reported extraordinary items as described in note 2 to the consolidated financial statements, on a consistent basis.

Calgary, Canada
March 9, 1990

Peat Marwick Thorne
Chartered Accountants

Consolidated Balance Sheet

as at December 31
(in thousands of dollars)

	1989	1988
Assets		
Current Assets		
Cash	$ 7,739	$ 5,830
Accounts receivable	4,906	4,681
Inventory of supplies	184	231
	12,829	10,742
Property, Plant and Equipment (note 3)	47,881	42,534
Deferred Financing Costs	590	697
	$ 61,300	$ 53,973
Liabilities		
Current Liabilities		
Accounts payable and accrued liabilities	$ 8,627	$ 10,510
Current portion of long-term debt	6,494	632
	15,121	11,142
Long-term Debt (note 4)	29,424	493
Convertible Debentures (note 5)	10,000	10,000
Preferred Shares of a Subsidiary Company (note 6)	—	37,500
Shareholders' Equity		
Capital Stock (note 7)	59,660	48,934
Deficit	(52,905)	(54,096)
	6,755	(5,162)
	$ 61,300	$ 53,973

Approved by the Board:

, Director

, Director

Consolidated Statements of Earnings and Deficit

Years Ended December 31
(in thousands of dollars)

	1989	1988
		restated
Revenue		
Production	$ 23,205	$ 17,276
Royalties	(4,008)	(2,923)
Alberta royalty tax credit	1,212	831
Net production revenue	20,409	15,184
Processing revenue	617	645
Other	134	365
	21,160	16,194
Expenses		
Production	7,005	5,694
General and administrative	1,729	2,311
Interest on long-term debt	4,962	605
Dividends on preferred shares of a subsidiary company (note 6)	546	2,457
Other interest	119	66
	14,361	11,133
Cash flow from operations (note 1(f))	6,799	5,061
Depletion and depreciation	(5,865)	(4,116)
Gain on sale of subsidiary companies (Note 10)	367	527
Net Earnings	1,301	1,472
Deficit at Beginning of Year	(54,096)	(55,568)
Share issue costs	(110)	—
Deficit at End of Year	$(52,905)	$(54,096)
Per Common Share		
Net earnings	$0.05	$0.05
Cash flow (note 1(f))	$0.24	$0.18

Consolidated Statements of Source and Use of Cash

Years Ended December 31
(in thousands of dollars)

	1989	1988 restated
Cash provided by (used for):		
Operating Activities		
Cash flow from operations	$ 6,799	$ 5,061
Change in non-cash working capital items related to operations	(2,061)	2,836
	4,738	7,897
Financing Activities		
Bank loan	34,071	(2,970)
Redemption of preferred shares of a subsidiary company	(37,500)	—
Issuance of common shares	10,726	1,258
Sale of convertible debentures, net of financing costs of $750	—	9,250
Capital lease obligations	1,234	612
Liability to limited partnerships	(512)	(759)
Share issue costs	(110)	—
	7,909	7,391
Investing Activities		
Property, plant and equipment expenditures		
Pursuant to flow-through share arrangements	(1,093)	(954)
Pursuant to current operations	(10,012)	(9,031)
Proceeds from sale of subsidiary companies	367	527
	(10,738)	(9,458)
Increase in Cash	1,909	5,830
Cash at Beginning of Year	5,830	—
Cash at End of Year	$ 7,739	$ 5,830

Notes to the Consolidated Financial Statements

(tabular amounts in thousands of dollars unless otherwise indicated)

1. Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements include the accounts of Czar Resources Ltd. and its subsidiary companies, which are wholly-owned.

(b) Petroleum and Natural Gas Operations

(i) The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas reserves are capitalized by cost centre. A separate cost centre is established for each country in which the Company operates, presently Canada. Costs include land acquisition costs, geological and geophysical expenditures, carrying charges on non-producing property, costs of drilling both productive and non-productive wells, related overhead expenditures and capitalized interest related to major development projects. Costs of acquiring and evaluating unproved properties and certain major development projects are excluded from the depletion calculation until it is determined whether or not proved reserves are attributable to those properties or major development projects are complete or impairment occurs. Costs are depleted by cost centre using the composite unit of production method based upon estimated proved reserves after royalties. Crude oil reserves are converted to equivalent units of natural gas based on the relative energy content of each product.

(ii) The net book value in each cost centre which can be carried forward for amortization against revenues of future periods is limited to an amount equal to the estimated future net revenues from proved reserves, based on current prices and costs, plus the lower of cost or estimated fair value of unproved properties. The aggregate net book value of all cost centres less deferred income taxes is limited to the estimated future net revenues from proved reserves plus the lower of cost or estimated fair value of unproved properties for all cost centres, less estimated future general and administrative expenses, financing costs and income taxes.

(iii) Included in production revenue and expenses is consideration received for the sale of properties by the Company to certain drilling partnerships. Principal and interest payments are received in installments which, in the aggregate, may not exceed a fixed percentage of net revenue from the wells drilled by the partnerships. Unpaid principal installments total $37,904,000 at December 31, 1989 (1988 - $38,901,000). Principal and interest payments, which are recorded as and when received, are included in revenue and expenses as follows:

	1989	1988
Production revenue	**$ 2,240**	$ 2,498
Royalties	**(371)**	(324)
Production expenses	**(608)**	(703)
	$ 1,261	$ 1,471

During the year the Company retroactively changed the manner in which it presents the payments received. In prior years the net amount received was shown separately in the Consolidated Statements of Earnings.

(iv) All of the Company's exploration and development activities related to petroleum and natural gas are conducted with others; the Company records only its proportionate interest in such activities.

(c) **Depreciation**

Depreciation of petroleum and natural gas production equipment and related facilities is provided on the composite unit of production method based on estimated proved reserves after royalties of each cost centre. Depreciation of other equipment is provided on a straight-line basis at rates which are estimated to amortize the cost of the assets over their useful lives.

(d) **Deferred Financing Costs**

Deferred financing costs relating to the convertible debentures are amortized on a straight-line basis over the term of the debentures.

(e) **Inventory**

The inventory of supplies is valued at the lower of cost or net realizable value.

(f) **Net Earnings and Cash Flow Per Common Share**

Net earnings and cash flow per common share are calculated using the weighted average number of common shares outstanding during the year of 28,498,358 (1988 - 27,393,230). The calculation of cash flow per common share is based on cash flow before changes in non-cash working capital items and after capitalization of overhead expenditures (note 3).

2. Change in Accounting Policy

Effective December 31, 1989, the Company retroactively adopted the new recommendations of the Canadian Institute of Chartered Accountants in respect of determining the classification of certain items as extraordinary in the Consolidated Statements of Earnings. Accordingly, the reduction in deferred income taxes realized on the application of prior years' losses and the gain on sale of subsidiary companies are no longer presented as extraordinary items.

The effect of this change on the current year is to increase earnings before extraordinary items by $604,000 ($0.02 per share). Previously reported earnings before extraordinary items for the year ended December 31, 1988 were increased by $1,805,000 ($0.06 per share). The change had no effect on reported net earnings.

3. Property, Plant and Equipment

	1989	1988
Petroleum and natural gas leases and rights including exploration, development and equipment thereon at cost	$69,416	$ 58,442
Other	1,146	1,169
	70,562	59,611
Accumulated depletion and depreciation	(22,681)	(17,077)
	$47,881	$ 42,534

Fixed assets include overhead expenditures which are incurred in the exploration for and development of oil and gas properties, amounting to $749,000 in the year ended December 31, 1989 (1988 - $633,000). The Company has not capitalized any interest costs or excluded costs from depletable costs in 1989 or 1988, pursuant to its accounting policies.

4. Long-Term Debt

	1989	1988
Bank credit facilities (i)		
Demand credit facility	$20,000	$ —
Revolving loan, including accrued interest	14,071	—
Revolving credit facility	—	—
Obligations under capital lease (ii)	1,847	613
Liability to limited partnership	—	512
	35,918	1,125
Less current portion	6,494	632
	$29,424	$ 493

(i) Bank Credit Facilities

On March 15, 1989 the Company redeemed $37.5 million of preferred shares of a subsidiary company (note 6) from proceeds of an interim demand loan in the amount of $37.5 million.

In June 1989 the interim demand loan was replaced by bank credit facilities comprised of a revolving credit facility of $3,355,000 ($3,905,000 at December 31, 1989), a demand credit facility of $20,000,000 and a revolving loan of $15,175,000 ($14,050,000 at December 31, 1989). The credit facilities are subject to review on May 31 of each year.

The revolving credit facility bears interest at prime plus 1/4% and is permanently reduced by $100,000 per quarter and $750,000 on April 30, 1990.

The demand credit facility bears interest at prime plus 1/4% and may be fixed at any time at the Company's option. The Company has fixed the rate of interest at 12.61% until May, 1992. Reductions in this credit line of $10,000,000 are required on March 15, 1993 and 1994.

The revolving loan bears interest at prime plus 1/4% and is reduced by $1,500,000 per quarter during 1990, $50,000 per quarter during 1991 and $1,962,000 per quarter during 1992.

The credit facilities are secured by a fixed charge debenture on certain assets and a floating charge debenture on all assets of the Company and assignments of accounts receivable and certain petroleum and natural gas properties and revenue interests therein.

The Company has agreed with the Bank not to make any distributions, including dividends, to its shareholders without the consent of the Bank. The Company has agreed to limit its working capital deficiency (as defined) to $1 million and to maintain certain cash flow levels and asset value ratios.

The Company has agreed not to, without the consent of the Bank: (i) issue common shares or rights to common shares at less than $1.25 per share, or (ii) issue in any 12 month period common shares of the Company in excess of 20% of the aggregate common shares and rights to acquire common shares outstanding at the commencement of such period without the approval by special resolution of each class of shareholders, voting separately.

In the event that the Company issues common shares, or securities convertible into common shares, the Bank has the option to participate on a secondary basis such that 50% of such offering shall be comprised of common shares then held by the Bank. Alternatively, the Bank may require that 25% of the proceeds of any such issue be paid to it and to apply such proceeds as a permanent reduction firstly against the revolving loan and thereafter against any other facility. The Bank does not have these rights in respect to flow-through share arrangements and employee option or savings plans.

ii) Obligations under Capital Leases

Future minimum lease payments are as follows:

1990	$ 725
1991	799
1992	491
1993	261
	2,276
Less amounts representing interest ranging from 13.8% to 16% per annum	429
	1,847
Less current portion	494
	$ 1,353

5. Convertible Debentures

The unsecured convertible debentures bear interest at 8.75% per annum payable semi-annually on June 15 and December 15 and mature on June 15, 1995.

The debentures are convertible into common shares of the Company at the option of the holder at any time prior to June 16, 1995 at a conversion price of $1.70 per common share. The conversion price is subject to adjustment in certain events.

The debentures are not redeemable prior to July 1, 1991. Thereafter, and prior to December 31, 1993 they are redeemable only if the common shares of the Company have traded at least at 125% of the conversion price for 20 consecutive trading days. Thereafter they are redeemable at any time. The debentures are redeemable at par plus accrued interest and at an amount equal to 103% of par if redeemed prior to July 1, 1992 which reduces by 1% for each succeeding twelve month period.

6. Preferred Shares of a Subsidiary Company

Pursuant to a debt restructuring agreement completed in September 1987 the Company's Bank held preferred shares of a subsidiary of the Company in the aggregate amount of $37.5 million. The preferred shares of the subsidiary had a dividend rate of 7.35% to February 15, 1988 and thereafter at 50% of the Bank's prime lending rate plus 1%, and were subject to mandatory redemption or purchase on or before March 15, 1989 (note 4).

7. Capital Stock

(a) Authorized Capital Stock

10,000,000 First preference shares issuable in series
10,000,000 Second preference shares issuable in series
Unlimited number of common shares

(b) Issued and to be Issued Common Shares

	Number of Shares	Amount
Balance December 31, 1987	27,052,406	$ 47,676
In settlement of liability to limited partnerships	100,000	200
Flow-through share arrangements	405,000	954
Employee savings plan	79,078	103
For cash on exercise of stock options	500	1
Pursuant to common share purchase warrants	498	—
Balance December 31, 1988	27,637,482	48,934
Flow-through share arrangements, net of incentives renounced	1,407,270	1,673
Employee savings plan	82,292	102
For cash, net of issue costs of $49,500	6,428,571	8,951
Balance December 31, 1989	35,555,615	$ 59,660

(c) Common Share Options

Directors, officers and employees hold options to purchase 2,607,000 common shares of the Company at an exercise price of $1.02 from time to time to September 22, 1994.

(d) Common Share Purchase Warrants

The Company has outstanding common share purchase warrants which entitle the holders to purchase common shares as follows:

Number of Shares	Price	Expiry Date
232,571	$2.16	October 31, 1990
232,571	$1.71	October 31, 1991
232,571	$2.09	September 23, 1992
2,700,000	$1.50	December 31, 1992

(e) Employee Savings Plan

On January 1, 1988 the Company instituted an employee savings plan which provides for employee savings of up to 5% of salary which will be matched by the Company in the form of common shares. During the year ended December 31, 1989 employees became entitled to receive 82,292 common shares (1988 - 79,078).

Effective January 1, 1990, the employee savings plan was cancelled and replaced with a plan whereby the employee becomes entitled to common shares of the Company and Orbit Oil & Gas Ltd. in the same ratio as the reimbursement ratio for the immediately preceding year as defined in the joint venture agreement (note 11).

(f) Flow-Through Share Arrangements

Subsequent to December 31, 1989 the Company incurred and renounced qualifying expenditures of $457,000 and issued 351,770 common shares at $1.30 per share pursuant to a flow-through share arrangement.

Pursuant to another flow-through share arrangement, the Company has an obligation to incur and renounce prior to February 28, 1991 $1,155,000 of qualifying expenditures. Prior to December 31, 1989, the Company issued 262,500 common shares pursuant to this arrangement. Subsequent to December 31, 1989 the remaining 262,500 common shares were issued

8. Income Taxes

At December 31, 1989, the Company had approximately $98,000,000 of tax deductions available to reduce future years' income for tax purposes. The benefit of the excess of the amount over the net book value of the related assets has not been reflected in the financial statements.

The following table reconciles the expected tax provision based on current combined federal and provincial rates (44%) to the actual tax provision.

	1989	1988
Expected income tax provision	$ 572	$ 648
Increase (decrease) in expected tax provision:		
Non-taxable gain on sale of subsidiary	(161)	(232)
Non-deductible preferred share dividends	240	1,081
Non-deductible provincial royalties and lease rentals	1,099	916
Non-deductible depletion	222	150
Other non-deductible items	30	48
Alberta royalty tax credit	(533)	(366)
Resource allowance	(1,231)	(748)
Earned depletion allowance	—	(219)
Utilization of prior years' losses	(238)	(1,278)
Actual income tax provision	$ —	$ —

9. Segmented Information

The Company has a single line of business which is the exploration for and the development and production of petroleum and natural gas in Canada. The Company's production revenue includes $3,072,000 ($2,620,000 U.S.) of export sales to the United States (1988 - $2,985,000; $2,500,000 U.S.).

10. Gain on Sale of Subsidiary Companies

In 1986 the Company received two promissory notes aggregating $2.1 million U.S. as consideration for the sale of shares of certain subsidiaries and because payment of the notes is dependent on certain future events, any gain is recorded as payment on the notes is received. To December 31, 1989 the Company has received $1.1 million U.S. in respect of these notes.

11. Related Party Transactions

In 1989 a corporation of which a shareholder, director and senior officer of the Company is a major shareholder, renewed its joint venture agreement with the Company for participation to a specified maximum in exploration and development of essentially all the exploration prospects of the Company. The corporation earns an interest ranging from 80% to 85% by paying 100% of the costs related to the participation interest. In the year ended December 31, 1989 the corporation made expenditures of $1,694,000 (1988 - $1,459,000) pursuant to the agreement. At December 31, 1988, accounts receivable included $411,000 due from the corporation.

During 1989 the Company entered into a joint venture and management agreement with Orbit Oil & Gas Ltd., a corporation with certain common directors and officers, whereby the Company and Orbit will share overhead costs and jointly participate in new exploration projects. Effective January 1, 1990, the Company will be reimbursed for its costs and expenses in providing services based upon the relative revenue and capital expenditures of the two companies.

Notes

Corporate Information

Board of Directors

R.W. Lamond[1]
Chairman of the Board
President and CEO

Frank Benevento II[1]
President and CEO
Energy Recovery Management, Inc.

Brian C. Bentz[1]
Vice President, Finance
H.A. Simons (Overseas) Ltd.
Vancouver, B.C.

Donald M. Deacon[2]
Independent Businessman
Charlottetown, P.E.I.

Ashley G. Down[2]
Merchant Banker
Advisor to Prudential-Bache Capital Funding
London, England

Ed Mattheis[2]
President
Melaar Resources Ltd.
Calgary, Alberta

Charles A. Teare
Executive Vice President
Calgary, Alberta

Allan R. Twa
Partner
Burnet, Duckworth & Palmer
Calgary, Alberta

Officers and Senior Personnel

Robert W. Lamond
Chairman, President and CEO

Charles A. Teare
Executive Vice President
and Chief Financial Officer

P. Richard Ewacha
Vice President, Production

Allan R. Twa
Corporate Secretary

Wayne T. Radcliffe
District Land Manager

Sharon P. Runge
District Land Manager

Herbert J. Visscher
District Exploration Manager

Alan A. Higgins
District Exploration Manager

Paul M. Boechler
Controller

T. Jim Grafton
Accounting Manager

Donald K. Clark
Production Manager,
British Columbia

Philip W. Payzant
Production Manager,
Alberta

Stuart Y. Chow
Engineering Manager

Russ M. Sych
Senior Production Foreman
Wimborne

Warren M. Smith
Senior Production Foreman
Fort St. John

Corporate Office

2100, 144 - 4 Avenue S.W.
Calgary, Alberta
T2P 3N4
Tel: (403) 265-0270
Fax: (403) 263-2341

Legal Counsel
Burnet, Duckworth & Palmer
Calgary, Alberta

Auditors
Peat Marwick Thorne
Calgary, Alberta

Registrar & Transfer Agent
Montreal Trust
Calgary, Alberta

Wholly-Owned Subsidiaries
Czar Financing Alberta Ltd.
Calgary, Alberta

Czar Gas Corporation Inc.
Calgary, Alberta

Stock Listings
The Toronto Stock Exchange
Trading Symbol CZR

The Alberta Stock Exchange
Trading Symbol CZR

(1) Audit Committee
(2) Nominees

CZAR RESOURCES LTD.

FIRST WESTERN PRINTING
PRINTED IN CANADA

CZAR RESOURCES LTD.
and Subsidiary Companies

AR44

GAS MARKETING

Virtually all of Czar's connected natural gas is under contract and was on production during the first six months of 1989. This near capacity utilization of Czar's producing natural gas resulted in industrial gas sales being 12% higher than those for the first six months of 1988 as follows:

Industrial Gas Sales (BCF)*	1989	1988
Alberta	6.6	5.3
British Columbia	3.7	3.2
Export	3.3	3.6
	13.6	12.1

* includes Czar and working interest participants

As part of a move to increase the volumes of gas dedicated to longer term, higher priced contracts, direct sales contracts with the Ontario industrial users which expired on June 30, 1989 were not renewed by Czar. These volumes will be dedicated to the Company's long-term KannGaz contract.

Czar's efforts during the second quarter of the year have been directed towards optimizing the deliverability capability under existing contracts. Projects initiated in this quarter include the following:

- In the Wimborne area of Alberta the construction and installation of a 10 MMCFD refrigeration plant for gas dedicated under a Progas contract.
- At Bashaw, Alberta the tie-in of the 4-20-42-21 W4 well to an Alberta Natural Gas contract.
- In North Monias, British Columbia, the installation of compression for 16 MMCFD of gas to the Prince George Pulp and Alberta and Southern gas contracts.

EXPLORATION

During the six months ended June 30, 1989, the Company drilled eleven wells resulting in ten gas wells and one dry hole. Three successful exploratory wells and one development well were drilled in northeastern British Columbia during the winter drilling season. The balance of the wells were drilled in central Alberta including two development wells in the Wimborne area during the second quarter.

While the second quarter drilling was limited to the two wells at Wimborne, Czar evaluated a large number of projects including acquiring producing or gas bearing properties adjacent to existing production facilities. This has resulted in the purchase of an interest in two gas wells in northeastern British Columbia, one of which is currently on stream, and a considerable number of drilling prospects for both Alberta and northeastern British Columbia for the third and fourth quarters of 1989.

Czar's Drilling Results were:

	1989	1988
Gas Wells	10	9
Dry Holes	1	3
	11	12

OUTLOOK

The time horizon for improvements in the economics of the natural gas business appear to be drawing closer. Increased prices and demand are expected in the early 1990's and with the commencement of production under the Alberta & Southern Gas Co. Ltd. contract in November of 1989, Czar will benefit from improved prices during this year. Steady expansion and enhancement of its natural gas contracts has put Czar in a position to realize the benefits from these improving natural gas economics.

On behalf of the Board,

R. W. Lamond
President
August 23, 1989

CZAR RESOURCES LTD.

Suite 2100, 144 Fourth Avenue S.W.
Calgary, Alberta T2P 3N4

Printed in Canada

Interim Report To Shareholders

CZAR RESOURCES LTD.

6 MONTHS ENDED JUNE 30, 1989

CZAR RESOURCES LTD.
and Subsidiary Companies

Rec'd
SEPT 13, 1989

On behalf of the Board of Directors of Czar Resources Ltd., I am pleased to report record natural gas production, and improved net earnings and cash flow for the first six months of 1989.

FINANCIAL

The significant increase in natural gas production achieved in the first six months of 1989 resulted in a 31% increase in total revenue to $10.0 million from 7.6 million in 1988. Cash flow for the period was $3.8 million or $0.13 per share, an increase of 32% from the $2.9 million or $0.11 per share recorded in the previous year. Net earnings for the period increased by 13% to $1.4 million up from $1.2 million recorded in 1988. Overhead for the period was reduced by recoveries from the operation of plants and facilities in previous years.

During the second quarter the Company completed negotiations with its Banker on the terms of the long-term credit facility which was used to redeem the balance of its preferred shares on March 15, 1989. The credit facility which was $37.4 million at June 30, 1989 has a flexible repayment schedule which will be reviewed annually upon completion of an independent engineering evaluation of the Company's reserves and adjusted according to the Company's production forecasts.

PRODUCTION

During the first six months of 1989 Czar's natural gas production averaged 39.7 million cubic feet per day. Natural gas sales which traditionally decline during the summer months have remained constant to the date of this report. The Company expects natural gas production to average approximately 40 million cubic feet per day for the balance of 1989.

Czar's production volumes before royalties were:

	1989	1988
Natural Gas (MMCF/D)	39.7	29.3
Oil and Natural Gas Liquids (BOPD)	403	424

Product prices received by the Company for gas and oil sales averaged:

	1989	1988
Natural Gas ($/MCF)	1.40	1.40
Oil and Natural Gas Liquids ($/BBL)	16.34	15.81

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF EARNINGS
SIX MONTHS ENDED JUNE 30, 1989
(unaudited)

	1989	1988 (Restated)
Revenue		
Production	**$ 10,195,021**	$ 7,457,119
Less: Provincial royalties	**1,410,341**	914,687
Freehold royalties	**568,179**	374,902
Alberta royalty tax credit	**(757,982)**	(396,992)
	1,220,538	892,597
Net production revenue	**8,974,483**	6,564,522
Principal and interest from property dispositions	**697,530**	727,381
Processing revenue	**289,448**	344,228
Other	**89,169**	15,759
	10,050,630	7,651,890
Expenses		
Production	**2,946,759**	2,392,162
General and administrative	**571,876**	1,002,933
Interest on long-term debt	**2,168,553**	108,710
Depletion and depreciation	**2,660,528**	1,957,870
	8,347,716	5,461,675
Earnings Before Undernoted Items	**1,702,914**	2,190,215
Dividends on preferred shares of a subsidiary company	**545,876**	1,259,398
Earnings Before Deferred Income Taxes and Extraordinary Items	**1,157,038**	930,817
Deferred income taxes	**367,146**	716,658
Earnings Before Extraordinary Items	**789,892**	214,159
Extraordinary items		
Gain on sale of subsidiary companies	**219,000**	282,455
Reduction of deferred income taxes on application of prior years' losses	**367,146**	716,658
Net Earnings	**$ 1,376,038**	$ 1,213,272
Per Common Share		
Earnings before extraordinary items	**$ 0.03**	$ 0.01
Net earnings	**$ 0.05**	$ 0.04
Cash flow - basic	**$ 0.13**	$ 0.11
- fully diluted	**$ 0.12**	$ 0.10

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF DEFICIT
SIX MONTHS ENDED JUNE 30, 1989
(unaudited)

	1989	1988 (Restated)
Deficit at Beginning of Year	**$(54,096,160)**	$ (55,568,401)
Net earnings	**1,376,038**	1,213,272
Deficit at End of Year	**$(52,720,122)**	$ (54,355,129)

CZAR RESOURCES LTD.

CONSOLIDATED STATEMENT OF SOURCE AND USE OF CASH
SIX MONTHS ENDED JUNE 30, 1989
(unaudited)

	1989	1988 (Restated)
Operating Activities		
Earnings before extraordinary items	**$ 789,892**	$ 214,159
Depletion and depreciation	**2,660,528**	1,957,870
Deferred income taxes	**367,146**	716,658
Working capital provided by operations	**3,817,566**	2,888,687
Change in non-cash working capital items related to operations	**(2,256,151)**	554,845
	1,561,415	3,443,532
Investing Activities		
Additions to fixed assets		
Current operations	**(5,867,699)**	(3,162,753)
Flow-through share arrangements	**(1,570,000)**	(726,027)
Government incentives on flow-through shares	**581,000**	—
Collection of notes receivable	**219,000**	282,455
Financing Activities		
Increase (decrease) in bank loan	**34,955,000**	(2,970,000)
Redemption of preferred shares of a subsidiary company	**(37,500,000)**	—
Capital lease obligations	**1,033,002**	—
Decrease in liability to limited partnerships	**(279,498)**	(479,498)
Sale of 8.75% convertible debentures net of financing costs	**—**	9,250,000
Common shares issued and to be issued		
Pursuant to flow-through share arrangements	**989,000**	726,027
For cash	**—**	750
On liability settlement	**—**	200,000
Pursuant to employee savings plan	**49,542**	50,441
Increase (Decrease) in Cash	**(5,829,238)**	6,614,927
Cash at Beginning of Period	**5,830,086**	—
Cash at End of Period	**$ 848**	$ 6,614,927